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Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

25 April 2022

Re: Request for Comment on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (Release No. IA-5955; File No. S7-03-22)

Dear Ms. Countryman:

Ernst & Young LLP is pleased to provide comments to the Securities and Exchange Commission (SEC or Commission) on its proposal related to private fund advisers.

Our comments address the Commission's proposed Rule 206-(4)(10) under the Investment Advisers Act of 1940 (the Advisers Act) that would require audits of the financial statements of private funds[1] managed by investment advisers that are registered or required to be registered under Section 203 of the Advisers Act.

Preparation of audited financial statements

We note that the Commission and the Commission's staff have provided guidance related to audits of the financial statements of special purpose vehicles performed pursuant to Rule 206(4)-2 under the Advisers Act (the Custody Rule).[2] We believe this guidance has worked well and is well understood. Accordingly, we believe the Commission should align the new rule with this guidance and not require a private fund to distribute separate audited financial statements if (1) the private fund is owned by one or more pooled investment vehicles (PIVs) that are controlled[3] by the private fund's registered investment adviser (RIA) or the RIA's related person(s);[4] (2) the private fund has no owners other than its RIA, its RIA's related person(s) or the PIV(s); and (3) the assets of the private fund are considered within the scope of the financial statement audit(s) of the PIV(s). These exceptions would allow investors who invest in private funds through PIVs, and therefore already receive audited financial statements of PIVs whose audits would include private fund assets in their scope, to avoid bearing the cost of private

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1 A private fund is defined by Section 202(a)(29) of the Advisers Act as an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940, but for Section 3(c)(1) or 3(c)(7) of that Act.

2 See Final Rule: Custody of Funds or Securities of Clients by Investment Advisers and IM Guidance Update No. 2014-07, *Private Funds and the Application of the Custody Rule to Special Purpose Vehicles and Escrows*.

3 See Rule 206(4)-2(d)(1) under the Advisers Act, which defines "control" as the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise.

4 See Rule 206(4)-2(d)(7) under the Advisers Act, which defines "related person" as any person, directly or indirectly, controlling or controlled by the adviser, and any person that is under common control with the adviser.

fund audits without receiving any incremental material information or benefit. At a minimum, we recommend that the SEC not require separate private fund financial statements when a single PIV owns and consolidates a private fund in its financial statements and there are no external investors for the same reasons.[5]

Commission notification by private fund auditors

The proposed rule would require an independent public accountant that completes the audit of a private fund's financial statements to notify the Commission electronically in the following situations: (1) promptly upon issuing an audit report to the private fund that contains a modified opinion and (2) within four business days of resignation or dismissal from, or other termination of, the engagement, or upon removing itself or being removed from consideration for being reappointed. The Commission requested comment on whether the proposed rule instead should contain similar requirements to Rule 17a-5 under the Securities Exchange Act of 1934, which requires a broker-dealer to notify the Commission upon an auditor termination and the auditor to provide a letter for the broker-dealer to file with the SEC stating whether the auditor agrees with statements made by the broker-dealer.

We agree that the Commission should be notified in these situations. However, we believe that the RIA, rather than the independent public accountant, should be responsible for notifying the Commission if either of these events occurs, consistent with Rule 17a-5(f)(3) and other existing SEC requirements, since the RIA is principally responsible for compliance with the proposed rule. We note that upon an auditor termination, both Rule 17a-5(f)(3) for broker-dealers and Item 4.01 of Form 8-K for issuers impose on the registered entity the primary responsibility for direct communications with the Commission. That is, the registered entity is required to make certain disclosures and the auditor is required to provide the entity with a letter for it to file with the Commission stating whether the auditor agrees with the statements made by the entity or if not, stating which statements the auditor does not agree with.

Similarly, if an issuer is advised by, or receives notice from, its auditor that disclosure should be made or action should be taken to prevent future reliance on a previously issued audit report or completed interim review related to previously issued financial statements, Item 4.02 of Form 8-K requires the issuer to make certain disclosures and the auditor to provide the issuer with a letter for it to file with the Commission stating whether the auditor agrees with the statements made by the issuer or if not, stating which statements the auditor does not agree with. Likewise, under Rule 17(a)(5)(h), a broker-

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[5] We note that the staff of the Commodities Futures Trading Commission (CFTC) provided no-action relief from CFTC regulation 4.22(c) in response to a request from the Investment Company Institute and the Securities Industry and Financial Markets Association, whereby a commodity pool operator (CPO) of an investment company registered under the Investment Company Act of 1940 (a registered investment company or RIC) that trades in commodity interests through a wholly owned subsidiary (known as a controlled foreign corporation or CFC) does not have to submit to the National Futures Association (NFA) a separate annual report for the CFC if the RIC consolidates the CFC in the RIC's audited financial statements and the CPO submits to the NFA an annual report that contains the RIC's audited consolidated financial statements. See CFTC Letter No. 13-51 and CFTC Letter No. 17-69, which clarifies CFTC Letter No. 13-51. We also note that while the CFTC no-action relief was for a wholly owned entity, we believe that a non-wholly owned private fund should not have to distribute separate audited financial statements if it meets the criteria we described above (e.g., if a PIV owns 95% of a private fund that has the same RIA as the PIV and the PIV consolidates the private fund in its audited financial statements that are distributed to the PIV's investors, and the PIV's general partner, which is a related person of the private fund's RIA, owns the other 5% of the private fund).

dealer is required to notify the Commission of certain serious noncompliance with the financial responsibility rules or material weaknesses; the auditor is only required to notify the Commission if the broker-dealer doesn't self-report or the auditor disagrees with the broker-dealer's notification.

Auditing standards for foreign private fund financial statements

The proposed rule would require audits be performed in accordance with US generally accepted auditing standards (US GAAS).[6] The Commission requested comment on whether there are certain non-US auditing standards that the proposed rule should explicitly include.

We believe the proposed rule should explicitly allow foreign private fund financial statements to be audited in accordance with the International Standards on Auditing (ISAs), which are high-quality auditing standards that are widely accepted worldwide and largely converged with US GAAS.

If the Commission were to adopt the proposed rule without modification and not provide for the use of the ISAs, investors in foreign private funds whose financial statements are currently audited in accordance with the ISAs may incur additional costs to obtain an audit that is also performed in accordance with US GAAS. We believe the differences between US GAAS and the ISAs are not of such significance to warrant the incremental cost of requiring audits of the financial statements of foreign private funds to be performed in accordance with US GAAS. Also, auditors in foreign jurisdictions who customarily perform audits in accordance with the ISAs would have to become proficient in US GAAS to ensure a high-quality US GAAS audit consistent with the ISA audit already being performed.

If the Commission in its final rule provides for a foreign private fund's financial statements that are audited in accordance with the ISAs to satisfy the proposed rule, we recommend that for consistency, the Commission consider proposing amendments to the Custody Rule to allow audits of foreign private fund financial statements that are performed in accordance with the ISAs to satisfy the Custody Rule. We further recommend that if, based on comments it receives, the Commission decides to change any requirements in the proposed rule (e.g., require audits less frequently than annually for new funds or for liquidating funds), the Commission should consider proposing amendments to the Custody Rule to align with the new rule.

Independence requirements for auditors of private fund financial statements — transition

The proposed rule would require that audits of private fund financial statements be performed by an independent public accountant that meets the standards of independence described in Rules 2-01(b) and (c) of Regulation S-X (SEC independence requirements). Currently, auditors of private funds whose financial statements are not used to satisfy the Custody Rule and who are not otherwise required to comply with SEC independence requirements instead comply with the independence requirements contained in the relevant auditing standards they use to audit the private fund's financial statements (for example, American Institute of Certified Public Accountants independence rules).

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6 An audit that is conducted in accordance with both US GAAS and the auditing standards of the Public Company Accounting Oversight Board would also satisfy the proposed rule.

The Commission proposed a one-year transition for compliance with the proposed rules, including the proposed audit rule. If the Commission were to adopt the proposed audit rule, we recommend that the Commission extend, for at least one additional year, the transition period for compliance with the SEC independence requirements for private funds whose auditors are not already subject to SEC independence requirements. This would provide sufficient time for private funds and their auditors to properly assess auditor independence and for private funds to hire an audit firm that meets SEC independence requirements if the private funds and their existing auditors are unable to terminate timely any services or relationships that would be inconsistent with SEC independence rules.

For example, if the Commission were to adopt a final rule that would become effective in 2022, the compliance date would be one year after the effective date, which would result in a compliance date in 2023. Since an auditor must begin to comply with SEC independence requirements as of the beginning of the earlier of the audit period or the professional engagement period, this would mean that for purposes of the audited financial statements of a private fund for the year ended 31 December 2023, an auditor that is not independent in accordance with SEC independence requirements would need to become compliant no later than 1 January 2023. That may not provide sufficient time for the private fund and its auditor to properly assess the auditor's independence and for the private fund to hire an audit firm that meets SEC independence requirements if the private fund and its existing auditor are unable to terminate timely any services or relationships that would be inconsistent with SEC independence rules.

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We would be pleased to discuss our comments with the Commission or its staff at its convenience.

Very truly yours,

Ernst & Young LLP

Copy to:

Mr. Jenson Wayne, Chief Accountant, Division of Investment Management
Mr. Paul Munter, Acting Chief Accountant, Office of the Chief Accountant